

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Speier Analyst: Nicole Kwon Bill Number: SB 30
Related Bills: See Legislative History Telephone: 845-7800 Introduced Date: 12-9-2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Golden State Scholarship Trust Deduction

SUMMARY

This bill would allow a deduction for contributions made by a qualified taxpayer to a Golden State Scholarshare Trust Account.

PURPOSE OF THE BILL

It appears the purpose of the bill is to allow a tax benefit for contributions to a Golden State Scholarshare Trust Account, thus encouraging additional funding.

EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately and operative for taxable years beginning on or after January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal law, Internal Revenue Code (IRC) Section 529 provides tax-exempt status to "qualified tuition programs" (QTPs). QTPs are programs established and maintained by a state, an agency, or an eligible educational institution to purchase tuition credits or make cash contributions on behalf of designated beneficiaries. Only states may establish cash contribution to QTPs. No amount is included in the gross income of a contributor to, or a beneficiary of, a qualified tuition program with respect to any distribution from, or earnings under, such program, except to the extent such distributions exceed qualified higher education expenses.

Any person may make contributions to a Section 529 plan. Contributions are not deductible. Under the Internal Revenue Service established "safe harbor," contributions in excess of those necessary to provide qualified higher education expenses of the beneficiary are prohibited.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

1/24/2005

For 2001 through 2005, federal law allows eligible individuals an above-the-line deduction for qualified higher-education expenses paid during the taxable year. For 2003, the maximum deduction was \$3,000 for taxpayers with modified Adjusted Gross Income (AGI) not in excess of \$65,000 (\$130,000 for a joint return). For 2004 and 2005, the maximum deduction for these taxpayers is \$4,000 and \$2,000 for taxpayers with modified AGI in excess of \$65,000 (\$130,000 joint) but not in excess of \$80,000 (\$160,000 joint).

California law conforms to federal law as it relates to tax-exempt QTPs. In addition, state law in the Education Code known as the Golden State Scholarshare Trust Act establishes authority for California's qualified state tuition plan. There is no limitation on who may make a contribution to a Golden State Scholarshare Trust Account or where a designated beneficiary must incur qualified higher education expenses.

California law does not allow an above-the-line deduction for qualified higher-education expenses.

THIS BILL

This bill would allow qualified taxpayers a deduction for contributions to a Golden State Scholarshare Trust Account. A qualified taxpayer is defined as an individual who, on behalf of a beneficiary, contributes money to a qualified trust and meets all of the other requirements of Section 529 of the Internal Revenue Code.

This bill would not allow a deduction for contributions made to QTPs established by eligible educational institutions in this state and elsewhere to purchase tuition credits.

Since this bill does not specify otherwise, this deduction would be considered a miscellaneous itemized deduction and allowed only to the extent that all miscellaneous deductions exceed 2% of adjusted gross income.

This bill would allow Franchise Tax Board (FTB) to require a trust to withhold an amount of the refund from the nonresidents of California in the event that any portion of the contribution made by a taxpayer to a trust is refunded back to the taxpayer.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. This bill uses the term "the taxpayer" on page 2, line 14. The bill needs to clarify whether "the taxpayer" applies to the one making the contribution or to the designated beneficiary. The absence of definitions to clarify "the taxpayer" could lead to disputes with taxpayers and would complicate the administration of this deduction.
2. This bill would authorize FTB to require a trust to withhold an amount of the refund from a nonresident of California in the event that any portion of the contribution made by a taxpayer to a trust is refunded back to the taxpayer. Determining the amount to withhold from a nonresident of California is not clear and could lead to disputes between taxpayers and FTB.

TECHNICAL CONSIDERATION

The bill omits subdivision (a), the author may wish to add “(a)” on page 1, line 3 after “17206.”

The author may wish to change the Golden State Scholarship Trust to the Golden State Scholarshare Trust to be consistent with Revenue and Taxation Code (R&TC) section 17140.

LEGISLATIVE HISTORY

Federal P.L. 104-188 (1996), amended by P.L. 105-34 (1997), established an exemption from federal taxation and tax-deferred treatment for contributions to and earnings from qualified state tuition programs.

AB 530 (Stats. 1997, Ch. 851) established the California Golden State Scholarshare program in conformity with the federal qualified state tuition criteria. It provided an exemption from state taxation and tax deferred treatment for earnings from the Scholarshare program.

AB 2797 (Stats. 1998, Ch 322) allows, by direct conformity to the federal provisions, an exemption from state taxation and tax deferred treatment for contributions to and earnings from any state's qualified state tuition program.

SB 1262 (Stats. 199, Ch. 664) made a number of technical changes to the California Golden State Scholarshare program under the Education Code, including making the Scholarshare Investment Board, which is chaired by the state Treasurer, responsible for administering the program instead of the Student Aid Commission.

OTHER STATES' INFORMATION

The states surveyed include *Illinois*, *Massachusetts*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois has the College Savings Pool program named “Bright Start.” A deduction is allowed from an individual's adjusted gross income for contributions made to the College Savings Pool.

Massachusetts is aligned with federal treatment of qualified tuition programs under IRC section 529, excluding distributions from the beneficiary's federal gross income to the extent the distribution is used to pay for qualified higher education expenses.

New York has the New York State College Savings Program in which an account owner may deduct contributions made to one or more family tuition plans from federal adjusted gross income in computing New York adjusted gross income.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses annually beginning in 2005-06.

Estimated Revenue Impact of SB 30 As Introduced 12/9/04, Enactment Assumed After 6/30 [\$ In Millions]		
2005-06	2006-07	2007-08
-\$6	-\$7	-\$8

Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of Scholarshare trust contributions deducted on tax returns in each taxable year and marginal tax rates of qualified taxpayers reporting such deductions.

Based on information provided by Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), at the end of 2004, the Golden State Scholarshare Trust consisted of 136,600 existing accounts with assets totaling nearly \$1.4 billion. Contributions to these accounts in the 2004 taxable year totaled approximately \$360 million.

Under the bill, approximately 33,000 taxpayers would deduct contributions projected at \$92 million on tax returns for the 2005 taxable year. The amount of deductible contributions projected at \$92 million in 2005 was derived from contribution data provided by TIAA-CREF. Applying an average marginal tax rate of 6% to the amount of deductible contributions derives a revenue loss of \$6 million for the 2005 taxable year. A 6% average marginal tax rate was determined by analyzing income distributions of individuals potentially contributing to the Scholarshare Trust. Taxable year estimates were converted to cash-flow estimates above. Cash-flow estimates reflect the ability of some taxpayers to accelerate tax benefits by adjusting their estimated tax payments.

The number of taxpayers (33,000) was derived from the number of Scholarshare Trust accounts (136,000). First, the number of accounts was reduced to represent the number of taxpayers (i.e., some taxpayers would establish an account for more than one beneficiary). Second, the remaining number of taxpayers was further reduced to eliminate taxpayers who would not itemize deductions or, if they itemized, would not have sufficient miscellaneous itemized deductions (with the proposed deduction in place) to exceed the 2% of adjusted gross income threshold. Roughly one-quarter of taxpayers contributing to the Scholarshare Trust would have deductible contributions under the bill.

ARGUMENTS/POLICY CONCERNS

As the bill is currently written it would allow a miscellaneous itemized deduction only to the extent that it exceeds 2% of the taxpayer's adjusted gross income. The author may wish to provide a tax benefit to all taxpayers making contributions to a Golden State Scholarshare Trust account, not just those who claim itemized deductions. If so, R&TC section 17072 would need to be amended to allow a deduction in arriving at adjusted gross income.

In addition, California taxpayers may make contributions to QTPs established by eligible educational institutions in this state and elsewhere to purchase tuition credits. California taxpayers may also make contributions to QTPs established by other states to cover qualified higher educational expenses in this state and elsewhere. This bill would not allow a deduction for contributions to these other QTPs.

LEGISLATIVE STAFF CONTACT

Nicole Kwon
Franchise Tax Board
845-7800
haeyoung.kwon@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov